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Shanghai Beer Brief 2007

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Report Highlights:

China is already the largest country in terms of beer production and consumption, and it still possesses tremendous growth potential due to the low per capita consumption. In recent years, China's beer market has undergone much consolidation; mergers and joint-ventures were established by either domestic breweries or foreign brewing companies in an effort to acquire greater market share in this very fragmented market place. In 2006, two-thirds of total beer sales volume in China was off-trade sales; however, that volume represented only 55 percent of the entire market in terms of sales value. In 2006, China imported 114.6 million liters of beer with a sales value of \$US920 million. Most sales of imported beer are on-trade transactions. Currently, because China's transportation infrastructure is not as well-developed as in Western nations, beer distribution remains regional.

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The China Beer Market

Introduction



Like China's overall economy, its beer market is experiencing steady growth. It is the largest country in terms of beer production and consumption. In 2006, 31 billion liters of beer were produced in China, which is in line with the average annual growth rate of 7 percent over the last ten years. Sales value reached 188.6 billion RMB, which converts to \$24.2 billion (calculated based on 1 USD = 7.8 RMB). Such a growth rate has led China to surpass the United States in becoming the number one beer-producing nation since 2002. This growth has attracted many foreign brewing companies to China. As

a result, its beer market is undergoing much consolidation by both foreign players as well as domestic firms. China's total beer consumption also ranks among the highest in the world, mainly due to the fact that it has the largest population in the world, estimated at 1.3 billion. The annual per capita beer consumption is estimated at 27.4 liters (Euromonitor). Compared with 130 liters in Germany, 80 liters in the United States, and 41 liters in Japan, China's per capita beer consumption remains relatively low. Because of the large population and low per capita consumption, China's beer market still has considerable growth potential.

Another factor that contributes to the growth of the beer industry is certainly the tremendous growth of China's economy. From 1995 to 2005, China has had 9% average annual GDP growth, leading to increases in disposable income and improvement in living standards for middle class Chinese. As their disposable income rises, many Chinese can now afford to purchase standard lager, and even experience imported premium beer. As this emerging middle class becomes more affluent, their demand for quality beer will spur continued growth in the beer market.

To capture this growth however, producers face a major obstacle in securing distribution. With the market being so fragmented, it is difficult for any single brewing company to dominate the entire Chinese market. Local Chinese consumers tend to favor beers from their own regions, mainly because local beers have long histories with the locality, but most importantly, because there are not many national brands to compete with. Also, poor transportation infrastructure makes it difficult to have an effective national distribution network. In order to penetrate the market and be able to deliver to as many regions as possible, brewing companies from overseas have been forming joint ventures and mergers with Chinese breweries. In doing so, they gain access to local markets through existing distribution channels, and with the existing brewing facilities, they can brew and bottle their foreign brand beers domestically, dramatically reducing costs. Because this is such an effective way to enter the Chinese market, the beer market has been going through a major consolidation in recent years.

Market Segmentation

Before further segmenting China's beer market, two major categories must be defined in order to avoid misunderstandings. China's beer market can be separated into two categories: imported and domestic. Imported beers refer to beers that are brewed overseas and imported into the country. Examples of imported beers include Guinness, New Castle, and Corona. Domestic beers include all beers that are being brewed within China, regardless of the origin of the brand. Aside from the countless numbers of regional Chinese beers,

there are a number of foreign brands that are domestically brewed. Budweiser, Carlsberg, and Asahi are good examples among other major domestic foreign-brand beers. Besides being categorized as imported or domestic, China's beer market can also be broken down into three segments according to price level.

Economy

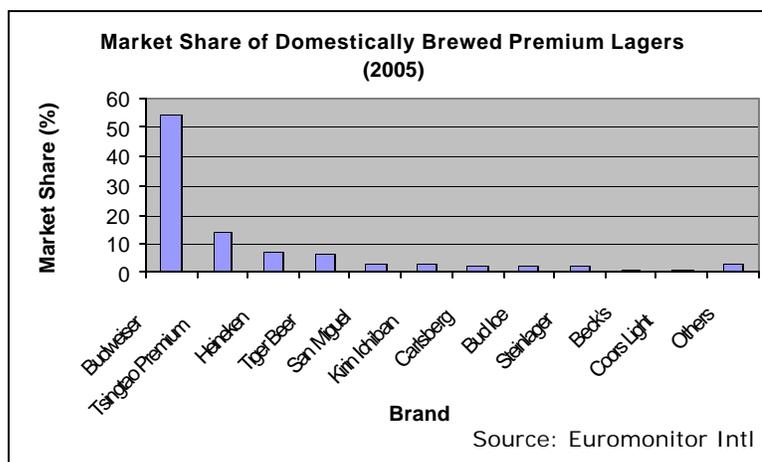
The economy segment of the beer market comprised 90 percent of total sales volume of the entire China beer market in 2006, which translates to 28.2 billion liters. It also accounted for 75 percent of sales value in the same year, which equates to roughly \$18 billion (Euromonitor). The economy beer segment is dominated by regional players throughout China. There are no imported economy beers, not only because all overseas beers are automatically labeled as premium beer, but also because the sales price of economy lager is so low that it would be unreasonable to import them and sell within this price range. The retail price for economy beer is roughly 7 RMB per liter. At the retail level, a 640 ml bottle has an average cost of 2.50 RMB. As China continues to grow, the beer market as a whole will become more competitive. The profit margin of economy lagers is already minimal and it will be squeezed even further. It is expected that this segment of the market will lose share to standard and premium beers as China continues to urbanize and the beer market as a whole continues to consolidate.

Standard

The standard beer segment has a market share of 7 percent in total sales volume as of the end of 2006, which also represents 12 percent of the total sales value. Similar to the economy segment, no imported beers will be priced at this segment because of its low pricing characteristic, which disable foreign beer firms to cover costs and earn a reasonable return. Prices of domestic standard lagers range from 7-20 RMB per liter. The reason for such a wide range of prices is because this range also suits some foreign brand beers that are being brewed domestically such as Budweiser and Carlsberg, and they are able to command higher prices compared to other regional competitors. Unlike the economy lagers, the standard segment is estimated to grow at a compound annual rate of 6 percent as the emerging middle class becomes more willing to substitute economy lager with higher quality beer.

Premium

The premium beer market has the least market share in terms of volume. In 2006, sales volume was estimated at 701.8 million liters, which is 3 percent of the entire beer market in China. Nevertheless, this 3 percent represents \$3.14 billion in sales value, which is 13 percent overall. This high level of representation is because the price of premium beer in China is at least 20 RMB per liter. Additionally, within this premium beer market, there are two sub-segments. One type of premium beer is brewed domestically; the other type is actually

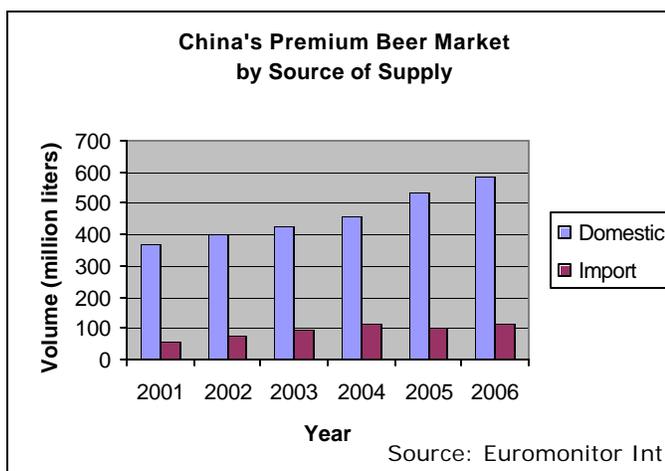


imported into the country. Interestingly, most domestically produced premium beers are of foreign brands, such as Bud Ice, Budweiser Gold, and Heineken. An exception is Tsingtao, which has a high enough international reputation to establish its own line of premium beer. In 2006, the sales volume ratio of domestic premium lager to total premium lager was estimated at 84 percent; by sales value, domestic premium is 71 of the entire premium market.

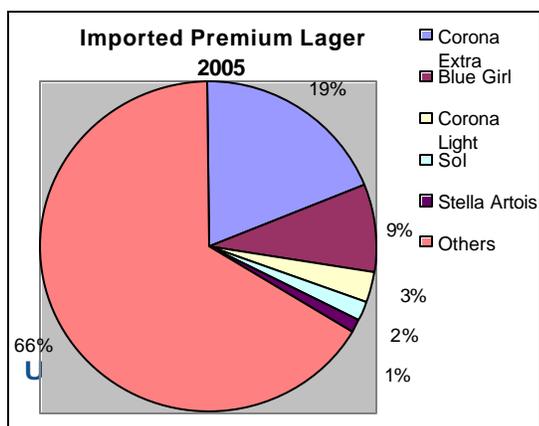
Import vs. Locally Brewed

Foreign beer companies, when they have decided to enter the Chinese market, have two options on how to carry out their operations in China; one is to import beers into the country; another option is to brew them domestically. Many multinational companies have the equity to acquire numerous local players in different regions of China, hoping to capture more market share. By merging with local breweries, overseas companies can bring technological know-how and experience to local firms. In return, local breweries have the experience to help foreign partners meet any government regulations in order to establish a presence in their respective regions through existing distribution channels. An example of a foreign brand beer being brewed in China is Budweiser. It is one of the first foreign beers that penetrated the China market.

Initially it started out as an import beer but as demand rose, Budweiser began to create joint ventures with local breweries and produce their beer domestically. Because of its early market entry and economies of scale, Budweiser is able to charge a more affordable price and still maintain a premium image. Currently, its share in the entire premium beer segment is estimated at 48 percent (Euromonitor), which overwhelmingly exceeds Tsingtao in second place with a 12 percent market share.



Another option for foreign companies to enter the Chinese market is through direct imports. Compared to a foreign beer that is brewed locally, production costs for overseas brewers are generally higher than if the beer were brewed in China, so imported beers carry a higher price tag than foreign beers brewed domestically. Additionally, transportation costs and import tariffs also need to be accounted for, pushing the final retail price even higher. In China, a good distribution channel that can support the high price of imported premium beers is distributing through food service venues. On-trade establishments provide stable outlets for imported beer sales and act as protective harbors for overseas brewing companies because pubs and bars often serve only a limited number of beer brands.



Regardless of the route imported brands used to enter the premium beer market, because of high profit margins, the market is becoming more competitive.

Import Consumption

When foreign brand beers enter the China market, they would be automatically perceived as premium beers in the eyes of the Chinese consumers. Even though the imported beer sales volume represents roughly just 0.5 percent of the entire beer market, it is a growing niche market as disposable income in China rises and the Chinese people become more affluent. As mentioned earlier, most sales of imported beer often occur at bars and restaurants that appeal to expatriates and the more affluent Chinese generation. In 2006, China imported 114.6 million liters of beer, of which 84 percent were sold on-trade. Total sales value of imported beer reached \$920 million USD; 92 percent were on-premise sales. Compared to retail sales at hypermarkets and supermarkets, selling import beers in restaurants and bars yields greater profit for both the overseas breweries and the establishment because the price of a glass of beer can be several times higher in a pub than a bottle of the same beer sold in a supermarket. For example, a glass of Guinness stout at an Irish pub can sell for 60 RMB, while a 12 FL ounce bottle only sells for 12 RMB in retail stores, a five-fold difference. Most sales of these imported premium beers are generated at restaurants, bars, and high-end retailers that provide service to foreign expatriates. In cities where there is a stable population of expatriates—such as Beijing and Shanghai—on-trade sales of imported beers is strongest at bars and clubs. Popular bars and pubs often feature imported beers from Europe, particularly from England and Ireland. They often target expatriates who favor darker beer. And with a generally excellent reputation overseas, imported brands can often gather a consistent loyal expatriate consumer base through these bars and pubs, along with the local Chinese who are willing to try them.

Shanghai Region

As the financial and business capital of China, Shanghai is one of the fastest growing cities in China. With a population estimated at around 18 million (including long-term residents), Shanghai's GDP reached \$127 billion dollars in 2006. Per capita GDP in 2006 was \$7131, significantly higher than the national average of \$1,700. This provides a suitable environment for the growth of foreign beer. According to the yearbook, total sales volume of beer reached 135,900 tons in 2005, which includes 98,100 tons in wholesale trade and 37,800 tons in retail trade. Like the rest of China, much of the sales volume is from economy and standard lagers. The dominant regional brand is Suntory. Other competitors include Reeb, Snow, Yanjing, Tsingtao, Asahi, Kirin, and Budweiser.

China Total Beer Import

		United States Dollars (millions)			% Share			% Change
Rank	City	2004	2005	2006	2004	2005	2006	- 06/05 -
	Overall	33.472323	27.014625	27.229006	100	100	100	0.79
1	Shanghai	7.987416	7.104122	7.320421	23.86	26.3	26.89	3.04
2	Tianjin	7.762935	6.339812	6.407028	23.19	23.47	23.53	1.06
3	Shenzhen	8.768154	4.818651	5.879312	26.2	17.84	21.59	22.01
4	Beijing	2.544713	3.539844	4.239804	7.6	13.1	15.57	19.77
5	Dalian	1.734721	2.169277	1.015861	5.18	8.03	3.73	-53.17

Source: China Customs, World Trade Atlas

Ever since 2000, China's total beer imports have been declining. In 2000, China's beer imports totaled \$92 million dollars; three years later in 2003, this amount fell to \$50.1 million dollars. By the end of 2006, China's beer imports were estimated at slightly more than \$27 million dollars. There are several factors that might contribute to such a decline.

After foreign brewing companies successfully entered the China market, they eventually started to brew their products domestically. Another factor might be that over time, some firms realized that China's minimal demand for foreign beer was not sufficient to sustain their business, forcing them to withdraw from the market. Also, strong competition exists among the different types of imported foreign alcohol because for example, consumers at a nightclub might consider drinking whiskey or vodka over a bottle of imported beer. According to retail experts, sales of imported spirits have increased significantly due to intensive promotion at nightclubs and karaoke bars. This also might have dampened Chinese consumers' appetite for imported beers.

Although China's beer imports have fallen significantly, Shanghai's imports of beer have remained relatively stable. In 2000, Shanghai's beer imports totaled \$10.6 million; as of 2006, it was estimated at \$7.3 million dollars. Despite the similar decline of China's total import beer markets a whole, Shanghai's market share in the overall imported beer market has been increasing. The reasons for this might seem evident. As the business capital of eastern China, Shanghai is home to a growing population of expatriates, estimated at more than half a million. Expats are the major source of consumption of imported beer, and that is the reason why more and more pubs, restaurants, and high-end retail markets have been established to attract and serve this group of consumers who are willing to spend; therefore, the imported beer market in Shanghai is becoming more competitive.

Consumer Taste

In recent years when the low-carb diet became the latest trend, light beer became a success in western markets, especially in America due to its low carbohydrate content. In China, light beers have also been well received, although not for the same low-carb reason. Most Chinese consumers prefer light beer for its taste. Light beer generally has a lower percentage of alcohol; therefore it tastes crisp and is not as bitter as normal beer. Light beers may also have a lower concentration of wort in order to decrease the bitterness of the beer. Conventional beers, for example Tsingtao and Budweiser, have an alcohol percentage and wort content of 4.0 percent and greater and 10°P, respectively. Light beers, on the contrary, often rate above 3.0 percent and 8°P, respectively. Some economy lagers even have alcohol content of just above 2 percent. Compared to traditional Chinese beers, western lagers are generally bold in flavor, especially dark beer and stout. They may not appeal to the mass Chinese market, but their goal is to focus on niche markets in the common market entry strategy for imported beer in China.

Entering A New Market



Since imported beer is automatically labeled as a premium, a suitable distributor should have a large distribution network that caters to high-end food services, such as hotels, restaurants, and bars. Since China's transportation infrastructure is not as developed as in the U.S. and Europe, distributors usually only cater to their localities. This is a key reason why China's beer market is so fragmented. Consequently, foreign beer companies must identify their target regional markets and typically find separate distributors for each market.

As previously mentioned, China's beer market pre-dominantly consists of economy and standard lagers, most of which are being distributed via off-trade outlets such as independent corner stores, grocery stores, and supermarkets. The rest are being distributed

through on-trade establishments such as restaurants, hotels, and bars. According to statistics gathered by Euromonitor International, in 2006, two-thirds of total beer volume in China was sold through off-trade outlets; the remainder was sold on-premise. In terms of sales value, however, 55 percent was from off-premise transactions; 45 percent on-premise.

On-trade vs Off-trade Sales of beer: Volume 2006

	Off-trade	On-trade	TOTAL
Volume (million litres)	21,152.2	10,030.0	31,182.2
Value (million RMB)	105,128.3	83,523.1	188,651.4

Source: Trade press (FMCG Report, FMCG Information), company research, store checks, trade interviews, Euromonitor International estimates

A third of the beer sales represents nearly half of the market value; this is because selling beer through restaurants and bars can definitely command a higher price. This is especially true for imported beer because of its premium status. People like to be seen drinking imported premium beers at bars because it projects a sophisticated image to others, and it is a way to show off their status. Therefore, even though a bottle of Heineken costs 60 RMB, which is probably 600 percent higher than what it costs at a supermarket, there is still plenty of demand for it. On the contrary, when Chinese consumers purchase beer at a supermarket, maybe for a family dinner, they tend to purchase local economy or standard lagers because there are no perceived additional benefits of drinking premium beer at home. This might also be the reason why independent food stores on the streets in general only carry local beers, and sometimes Budweiser.

Off-trade Sales of Beer and Distribution Format: % Volume Analysis 2006

	% Off Trade
Supermarkets/hypermarkets	24.0
Independent food stores	68.5
Convenience stores	7.0
Discounters	0.0
Specialists	0.0
Direct sales	0.0
Others	0.5
Total	100.0

Source: Trade press (FMCG Report, FMCG Information), company research, store checks, trade interviews, Euromonitor International estimates

Since China is a net beer producing country of mostly economy and standard lagers, it is reasonable to assume from the above table that almost all of China's beers being sold off-trade through independent food stores ("mom-and-pop" shops) are local lagers. Premiums are generally sold through supermarkets and the growing number of hypermarkets such as Carrefour, Wal-Mart, and Metro.

Regulation & Tariffs

This year marks the fifth year anniversary of China joining the World Trade Organization. When China joined the WTO, the tariff for imported beer was been eliminated. Nevertheless, once the beer has been imported into the country, it is currently subjected to a 17 percent Value Added Tax (VAT). In addition to VAT, a consumption tax is added according to the manufacturer sales price (MSP) of the beer, as shown below.

	Consumption Tax
Beer with msp exceeding RMB 3,000/ton	RMB 250/ton
Beer with msp less than RMB 3,000/ton	RMB 220/ton
Unbranded beer	RMB 250/ton

Source: USDA GAIN Report Number: CH4620 (South China's Beer and Wine Market: A Window of Opportunity 2004)

For every imported product entering a Chinese port, China Inspection & Quarantine (CIQ) has to take test samples from each shipment for health safety measures. This procedure is no different for imported beer. Besides testing samples, CIQ also examines the beer label to ensure that it meets Chinese standards. Each label should include the following information in Chinese:

- 1) Brand & Company name
- 2) Ingredients
- 3) Net weight (ml)
- 4) Alcohol content (%)
- 6) Wort content (°P)
- 7) Production Date (yy/mm/dd)
- 8) Shelf life / Expiration date
- 9) Place of production
- 10) Packer / Distributor (name & address)
- 11) Country of Origin

Label requirements in China tend to change very frequently, so it is recommended that before actually exporting the beer shipment, overseas breweries should send an example of the label to importers/distributors in China to have it approved by CIQ before hand. Therefore, not only by providing promising distribution outlets, a good distributor will assist foreign brewers by also helping sellers meet government regulations, such as providing proper labels and the necessary export/import documents.

Useful Contact Information

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Appendix A:

China Import Statistics														
Commodity: 220300, Beer Made From Malt														
By Volume														
Calendar Year: 2001 - 2006														
Partner Country	Unit	Volume						% Share						% Change 2006/2005
		2001	2002	2003	2004	2005	2006	2001	2002	2003	2004	2005	2006	
World	L	53757363	43585174	43381407	26831939	21126589	21319824	100.00	100.00	100.00	100.00	100.00	100.00	0.91
Mexico	L	12094318	13139535	12476954	13530734	12717608	10567696	22.50	30.15	28.76	50.43	60.20	49.57	-16.91
Germany	L	6715770	19094116	19140481	5966813	2794164	4951429	12.49	43.81	44.12	22.24	13.23	23.22	77.21
Korea South	L	1444032	1912261	1460921	3430239	2479359	2472799	2.69	4.39	3.37	12.78	11.74	11.60	-0.26
Malaysia	L	549651	229509	576667	947158	812576	1054237	1.02	0.53	1.33	3.53	3.85	4.94	29.74
Netherlands	L	17794503	5240205	2850963	482136	982913	596120	33.10	12.02	6.57	1.80	4.65	2.80	-39.35
Ireland	L	47313	54654	70819	133387	254940	358272	0.09	0.13	0.16	0.50	1.21	1.68	40.53
Russia	L	0	0	0	36056	266006	290899	0	0	0.00	0.13	1.26	1.36	9.36
United States	L	146897	94178	24214	23049	73272	265198	0.27	0.22	0.06	0.09	0.35	1.24	261.94
United Kingdom	L	101702	100405	139177	149691	233808	218957	0.19	0.23	0.32	0.56	1.11	1.03	-6.35
Belgium	L	42240	64386	104421	139150	182962	202513	0.08	0.15	0.24	0.52	0.87	0.95	10.69
France	L	10793049	16526	14610	10341	109457	76786	20.08	0.04	0.03	0.04	0.52	0.36	-29.85
Japan	L	23960	29435	27984	45859	45540	56348	0.04	0.07	0.06	0.17	0.22	0.26	23.73

Source: China Customs, Global Trade Atlas

Appendix B:

China Import Statistics													
Commodity: 220300, Beer Made From Malt													
By Value													
Calendar Year: 2001 - 2006													
Partner Country	United States Dollars						% Share						% Change 2006/2005
	2001	2002	2003	2004	2005	2006	2001	2002	2003	2004	2005	2006	
World	69428007	52461496	50145466	33472323	27014625	27229006	100.00	100.00	100.00	100.00	100.00	100.00	0.79
Mexico	13106699	15512172	15958874	17305544	16407335	13659124	18.88	29.57	31.83	51.70	60.74	50.16	-16.75
Germany	9518408	25243935	22284238	7177279	3519129	6411246	13.71	48.12	44.44	21.44	13.03	23.55	82.18
Korea South	940349	1601540	1403881	3515828	2508015	2260417	1.35	3.05	2.80	10.50	9.28	8.30	-9.87
Malaysia	23740066	5784068	2921381	701061	1190953	1285190	34.19	11.03	5.83	2.09	4.41	4.72	11.82
Netherlands	752211	427582	1006125	1857067	1149354	831752	1.08	0.82	2.01	5.55	4.25	3.05	-30.16
Ireland	148948	169196	217856	420569	585940	662913	0.21	0.32	0.43	1.26	2.17	2.43	13.14
Belgium	29070	79343	188703	303348	439969	508405	0.04	0.15	0.38	0.91	1.63	1.87	15.55
United Kingdom	100841	123804	206595	234694	422158	459673	0.15	0.24	0.41	0.70	1.56	1.69	8.89
United States	0	0	0	28436	218518	354475	0	0	0	0.08	0.81	1.30	247.94
Russia	15699286	19630	20639	12716	212665	251710	22.61	0.04	0.04	0.04	0.79	0.92	15.19
France	273826	67007	45781	28611	101877	160256	0.39	0.13	0.09	0.09	0.38	0.59	-24.64
Japan	34519	42959	93010	75719	83842	116067	0.05	0.08	0.19	0.23	0.31	0.43	38.44

Source: China Customs, Global Trade Atlas